Press Release

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Oliver Wyman Report Highlights Risks to Markets from Basel Reforms; Recommends Further Impact Analysis

GFMA Urges Basel to Undertake Period for Observation and Adjustments to Rules

Washington, 10 August 2016 – The Global Financial Markets Association (GFMA) today released a new report commissioned from Oliver Wyman on the interaction, coherence, and overall calibration of post crisis regulatory reform measures agreed upon, or under active consideration, by the Basel Committee on Banking Supervision (BCBS)[1]. The primary objective of the report is to consolidate and interpret for ease of use the large and growing base of research on these topics, in order to assist the Basel Committee, and other policymakers and analysts, in their consideration of how to optimize the global regulations. GFMA also made recommendations for regulatory action developed from the report findings.

Summary of Findings

The report finds a broad consensus that the initial Basel III package made the banking system more resilient. However, the majority of the economic cost and benefit analyses have been completed before the latest set of revisions to the rules and therefore does not capture the current balance between the costs and benefits of the regulatory package. Implementation of these rules is creating higher intermediation costs which are likely to be transmitted to users of the banking system and the broader economy. Regulation is also fundamentally changing the shape of banks' balance sheets and business models as well as the structure of financial markets, with resulting changes in their liquidity, efficiency and effectiveness.

For example, the report notes that banks' trading balance sheets have contracted by 25-30% since 2010. Its review of existing literature shows impacts to lending channels, capital markets and economic growth. Median estimates derived from the literature for potential increases in credit spreads in the long term as a result of Basel III reforms are 60 to 84 basis points, depending upon region, while bank loan volumes would decline 2.6% for each 1 percentage point increase in required capital ratios. While regulated banks have significantly increased their stability and resiliency, markets could become less stable and more vulnerable to shocks, which, combined with higher transaction costs, could push up liquidity premiums demanded by investors and there is some evidence of this happening already.

While in many cases changes to the business models of banks and the structure of markets were intended, in other areas it is likely that the cumulative impacts go beyond those anticipated and may negatively affect the functioning of the financial system. Further, there is a concern among some observers that the ongoing Basel workstreams will significantly add to banks' capital requirements, may exceed appropriate levels, and counter some of the national and regional initiatives to meet G20 growth commitments.

"We welcome the Basel Committee's undertaking to review the interaction, coherence and calibration of post-crisis reforms and hope the Oliver Wyman analysis will be a helpful

[1] The report also considered the impact of the Total Loss Absorbing Capacity (TLAC) as proposed by the Financial Stability Board given its direct interaction with the BCBS rules.

resource to them as they move forward," said Kenneth E. Bentsen, Jr., GFMA chief executive officer. "It is inevitable that some adjustments will need to be made after delivering such a comprehensive and complex programme of regulatory reforms during a period of rapidly changing financial markets. Importantly, Oliver Wyman's report highlights the need for a more thorough understanding of all the impacts of current rules on the functioning of markets and the implications for end users before finalizing any new requirements."

Bentsen added, "Indeed, in the absence of a comprehensive assessment of the economic impacts and coherence of the Basel III financial reform agenda, and the introduction of so-called Basel IV proposals that will substantially change the basis of measuring capital requirements and potentially affect the supply and pricing of financing for businesses, we urge the Basel Committee to commit to ongoing observation and willingness to make adjustments to rules given the short time frame for consideration and completion. GFMA has proposed specific recommendations to the Basel Committee on their entire suite of Basel III and IV reforms to ameliorate disproportionate and unnecessary increases in capital and liquidity requirements and ask that the Committee take the time necessary to ensure that they are properly considered."

GFMA Recommendations

In light of the report findings, GFMA proposes the following high-level recommendations for regulatory action, in addition to the detailed responses it has provided the Basel Committee on specific proposals (found here):

1. Building upon the issues identified in the Oliver Wyman Report, identify cases where there may be unnecessary duplication or conflicts between specific regulatory requirements and broader policy goals, as well as unintended consequences. Through this, we believe liquidity could be added back into the market without reducing safety and soundness.

2. Perform an overall assessment of the calibration and timing of the reforms in light of the cumulative impact of the full set of rules, including detailed empirical analysis that supports that such requirements are appropriately targeting activities at an appropriate level of risk tolerance consistent with economic growth and lending objectives. In addition, in that Basel III is not yet fully implemented and its impact on markets and end-users unknown, we recommend a careful observation period of "Basel IV" until such time as the full impact of the Basel III program is considered.

3. Taking into consideration the literature and measures identified in the Oliver Wyman Report, develop a collection of usable metrics that should be considered both on a current and forward-looking basis in analysing broader impacts of the regulatory package. Particularly, we recommend rigorous analysis on the impact on capital markets including impact on specific market segments, specific instruments, primary vs. secondary markets, impacts on emerging markets, and the changing dynamics of investment behaviours. Such analysis would involve more fully securities regulators in the development of a framework for an end-to-end impact analysis on the capital markets, including analysis of market liquidity, given the interplay between prudential and market regulation.

4. The FSB, in consultation with the BIS, and relevant stakeholders in the public and private sector, should develop a mechanism for a principles-based process by which financial regulators would conduct transparent and formalized consultations on a cross-border basis in order to support informed regulatory design and implementation that minimizes conflicts, redundancies and unintended consequences and takes into account the interaction, coherence and overall calibration of financial regulation.

GFMA's cover letter with recommendations is available here: http://www.gfma.org/correspondence/item.aspx?id=829. The full Oliver Wyman report is available here: http://www.oliverwyman.com/insights/publications/2016/aug/post-crisis-basel-reforms.html. Links to GFMA's specific issue responses: Leverage Ratio; Internal Risk Models; Operational Risk; Fundamental Review of the Trading Book; Net Stable Funding Ratio; Margin and Capital Requirements for Covered Swap Entities; Liquidity/PWC Study; Letter to Governor Fischer; More.

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The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit http://www.gfma.org.